CHASE

International Finance

Vol. XVI, No. 7
March 30, 1981

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

U.K. Budget Squeeze Expected to Continue

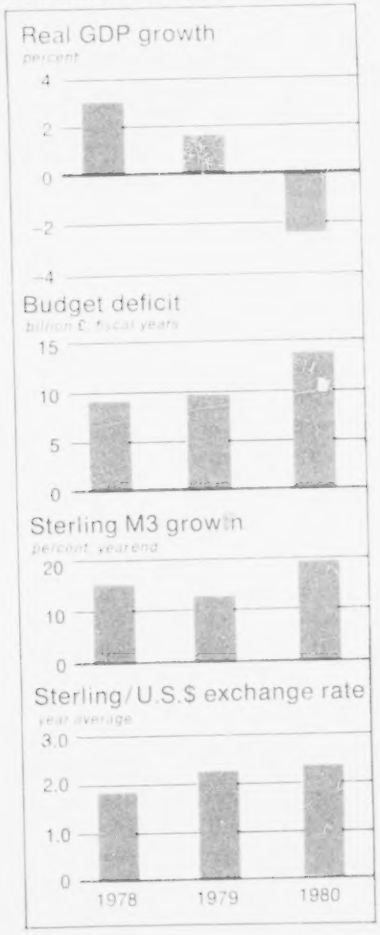
The Thatcher Government has now presented three budgets to the U.K. Parliament since its election in May 1979. The first two were severely deflationary, and many expected the 1981-82 budget to represent something of a change in direction. In fact, the overall policy stance of the new budget shows little change. It still gives priority to fighting inflation by means of monetary control.

The new budget does seek to redress the imbalance between fiscal and monetary policies, however. The government has been faulted for pursuing a tight monetary policy combined with a rather loose fiscal policy—evidenced by rising government spending and a huge budget gap. This combination tends to squeeze the private sector by boosting interest rates. This squeeze has been further aggravated by sterling's climb, which has eroded profit margins in the export sector.

The new 6%-10% target for money supply (£M3) growth—while lower than the previous range of 7%-11%—actually represents an easing of policy because it is based on February 1981, a month in which the money stock was well above target. On the fiscal side, the new public-sector borrowing requirement (PSBR) is targeted to be much smaller than last year as a result of rising personal tax revenues—which will once again squeeze the private sector—rather than reduced government spending. Indeed, the only hope of reflation is that a reduced budget deficit will allow lower interest rates and a lower exchange rate.

The government has begun the process of interest- and exchange-rate easing by cutting the Minimum Lending Rate to 12% from 14%. Further cuts may be made later this year. But the PSBR in 1981-82 will almost certainly exceed the budget forecast, thus leading to uncertainty over government funding tactics and the future course of interest rates. As for the pound, the initial effect of the budget has been to boost it. And although oil prices have softened somewhat, OPEC members are likely to decide to reduce supplies when they meet in May so that the "North Sea" effect may continue to buoy sterling. Furthermore, the ongoing recession will keep the balance on current account strong. Thus, while declining interest rates may lead to some fall in sterling, any weakness should be limited. If, as is widely expected, interest rates decline in the near term in the United States as well as in Germany and other European Monetary System member countries, the likelihood of reasonable sterling strength would be further enhanced.

Selected U.K. economic indicators



Belgium's new incomes policy should break the fast pace of wage increases.

Belgium has taken a much needed step toward a sounder economic structure. The recently accepted incomes policy states that no wage increases will be granted in excess of automatic cost-of-living adjustments for new wage contracts for the next two years. Since 1973, real wages per wage earner have risen at a 3.4% average annual rate—compared with the European Economic Community average of 1.7%—and have far exceeded Belgium's 2.2% annual growth in labor productivity. This sharp climb in inflation-adjusted wages is largely responsible for the secular rise in unemployment—to 9.8% last year from only 2.4% in 1973. It has also squeezed profits in manufacturing, so that in 1979 the level of manufacturing investment in constant prices was 30% below the level prevailing in 1970. The impetus for agreement on the income policy was not concern over the distribution of income, but rather the growing current-account deficit, which is expected to widen further from the $6 billion posted last year.

Portugal's new economic plan targets may be hard to hit in 1981.

The Portuguese authorities have unveiled an ambitious four-year economic program. The plan envisages average annual real GDP growth of 5% through 1984, with investment growth of 8%, and a drop in the inflation rate to 10%. It does, however, acknowledge the probability of a widening balance-of-payments gap. Economic performance in 1980 suggests that the plan's targets are not overly optimistic. Last year, economic growth of 4.7% was attained, with investment advancing by 8%, and inflation easing to 16.6% from 24.2% in 1979. Moreover, the current-account deficit in 1980 was $1 billion, only $200 million higher than officially forecast. A repeat performance in 1981, however, will not be easy. The worldwide recession is inhibiting export-led growth, and a drought has hurt agricultural output and hydroelectric power generation. Slower real GDP growth of 2.5%–3% is forecast for 1981, as is a widening in the current-account shortfall to $1.7 billion. In addition, underlying inflationary pressures are expected to push consumer price growth back up to 20%.

Israeli economic sluggishness last year did little to dampen inflation.

Israel's GNP grew, in real terms, by less than 1% last year, and unemployment reached more than 5% of the workforce by yearend. The economic slowdown did help narrow the civilian trade deficit to $2.6 billion from $3 billion in 1979, but the current-account deficit may have increased slightly, mainly the result of higher defense imports. The economic weakness last year had little impact on the country's rate of inflation, which reached 133% at yearend. This prompted Finance Minister Yoram Aridor to launch a fresh initiative to cut inflation and spur growth. The latest measures include a reduction in purchase taxes, the reintroduction of subsidies on energy and basic foodstuffs, and an easing in personal taxes. These are aimed at lowering inflation expectations and boosting economic growth, thereby permitting the government to recoup lost revenues. Short-term success in cutting the rate of price rise, however, will only be sustained over the longer term if the Israeli budget deficit can be reduced and monetary growth curtailed.

Taiwan's trade account was balanced last year, against all odds.

Despite an unfavorable trade climate last year, Taiwan—dependent on exports to the West and on imported oil—succeeded in balancing its trade account. Two-way trade expanded 28% from 1979 to almost $40 billion. Manufactured exports benefited from political instability in rival South Korea. In addition, growing demand for light industrial raw materials in the People's Republic of China caused exports to Hong Kong (as entrepot) to surge. The strong merchandise trade showing was offset, however, by a widening deficit on the invisibles account. Taiwanese tourists spent more abroad than foreign tourists in Taiwan, and outward transfers by Taiwanese nationals were large. As a result, the current account registered a deficit of about $1 billion, and foreign borrowing was stepped up to fill the gap. The external economic outlook for 1981 is uncertain. Although greater oil price stability is expected, lingering recession in Taiwan's major export markets and reviving Korean competition are worrisome. Even with the anticipation of some recovery in sales to the West in the second half of this year, a small trade

deficit seems unavoidable. And with trends in invisibles unchanged, the current account deficit is likely to widen.

Japanese government announces measures to spur lagging economic growth.

Responding to signs of unexpected economic weakness in the Japanese economy—real GNP advanced at a seasonally adjusted annual rate of only 2.3% in the final quarter of last year—the Japanese authorities announced a variety of measures to spur growth. The economic package is comprised of fiscal measures to aid small and medium sized businesses, boost housing construction, and accelerate public works spending. But fiscal stimulation is limited, owing to the government's desire to reduce the budget deficit. The relaxation of monetary policy is more significant. The Bank of Japan cut its discount rate 100 basis points to 6.25%, lowered reserve requirements, and abolished restrictions on commercial bank lending for the second quarter of 1981. Interest rates on deposits are also to be cut. Banks have responded by slashing their prime rate 75 basis points. Despite these measures, however, the economy's inventory adjustment will not be completed before midyear, and consumer spending is unlikely to strengthen until after the spring wage increases. Thus, economic activity is not expected to pick up much before the third quarter.

Mexican economic growth eased slightly in 1980, but oil output and reserves jumped.

The rate of real GDP growth in Mexico slipped to 7.4% last year from 8% in 1979, the result mainly of a drop in manufacturing output. Manufacturing production was expanding by only 4.5% by October 1980, compared with growth rates of 8–10% early in the year. Behind the manufacturing slowdown was excessively rapid growth of demand pressing up against available capacity, which led to materials shortages and transport delays. The demand pressures also helped push the rate of inflation to almost 30% by the end of 1980, compared with a year-earlier rate of 20%. Petroleum production, however, was up by more than 20% last year, and the level of proven reserves was boosted to 68 billion barrels from 60 billion barrels. GDP growth in the current year is expected to remain in the 7.5% range as the oil output rate continues to rise and as agricultural output improves in response to added investment.

Cameroon external-account outlook brightened by growing oil output.

Cameroon's three-year-old oil industry is expected to attain production levels of 80,000 barrels per day this year and 200,000 bpd by 1985. Rising oil export receipts, which are projected to hit the $1-billion mark this year, are especially fortuitous since the country's agricultural export receipts are depressed by low prices for its chief commodity exports, cocoa and coffee. With full production at the soon-to-be-opened Victoria refinery scheduled for 1982, imports of oil products could be virtually eliminated. As oil output rises, Cameroon could see a net surplus on oil account of about $900 million in 1982 and a surplus of almost $1.5 billion by 1983. Aided by increasing income on the services account from the expansion of the national air and shipping lines, Cameroon could eliminate its traditional current-account deficits by 1983 and enjoy surpluses thereafter.

Wheat price outlook bullish, with world supplies contracting once again.

Wheat prices are expected to rise substantially in the second quarter of this year, owing to tight supplies and growing demand. World wheat production is projected to reach some 442 million metric tons in crop year 1980–81, ending in June, compared with 422.2 million tons produced in 1979–80. But with world utilization expected to climb to about 450 million metric tons from 443.7 in 1979/80, ending stocks are expected to narrow to approximately 70 million metric tons in 1980–81 from 79.4 million tons a year earlier. Ending stocks of wheat as a percent of utilization are likely to drop to 16% in 1980/81—a substantial reduction from the last decade's carryover low of 17.3% recorded in 1972–73. The crop year 1980/81 will mark the second consecutive annual decline in total world wheat supplies. Prices for Kansas City "No. 1 hard red winter" wheat are thus expected to approach $5 per bushel in the second quarter of calendar 1981. Prices are then expected to ease in the second half of the year after the 1981–82 wheat crop is harvested—barring shortfalls created by adverse weather.

Bears in the Corporate Bond Market?

During the first quarter of 1981, corporations have moved to lengthen the maturities of their credit market liabilities. The volume of corporate nonconvertible bonds issued since the first of the year has approximated $7.3 billion, compared with $4 billion during the last quarter of 1980. Short-term credit (as measured by commercial and industrial loans at large commercial banks plus nonfinancial commercial paper) has increased only $1.5 billion over the same period, compared with an $8 billion increase during the fourth quarter.

This debt extension by nonfinancial corporations has occurred during a sizable decline in short-term rates, while long-term rates have remained near record levels. For example, since the first of the year, the rate on 90-day Aa industrial paper has fallen 325 basis points, while the yields on new 7-year and 20-year Aa industrial bonds have both *increased* by 50 basis points.

This behavior by firms may, at first glance, seem paradoxical, given the financing behavior exhibited during the last upswing in both short- and long-term interest rates. During the last half of 1980, a sizable number of firms postponed issuing long-term debt, relying on temporary short-term financing until long rates began to decline. In contrast, long-term rates during the March rush to the bond market were at levels *above* those of November of last year, when the volume of new issues was one of the smallest on record.

One obvious explanation is a reversal of corporate expectations concerning the future path of long-term interest rates. The recent volume of financings indicates that the market does not expect a material decline in bond rates in the near-to-medium term. Indeed, it is difficult to view the recent surge in bond financings in any other light.

Moreover, since bond rates usually reflect the market's inflation expectations, the market seems currently to be registering pessimism. And these pessimistic inflation expectations could indicate strong skepticism concerning government economic policies.

This market skepticism is, to some extent, being hedged, however. A substantial proportion of the bond issues (approximately 60%) since the first of the year have had medium rather than long-term maturities. To be sure, the dominance of medium-term issues in part reflects a restricted availability of long-term funds. But it may also be a sign of some optimism by issuers about an eventual improvement of inflation.

Nevertheless, on balance, a bearish atmosphere is likely to dominate the bond markets for some time. Uncertainty over congressional response to the administration's fiscal proposals is only one part of the problem. Even if enacted, the ultimate effect of the proposals is still regarded by the market as highly uncertain.

A Brief Respite for the Auto Industry

The surprisingly warm response of new-car buyers to the end-of-winter sales rebate programs provided what is likely to be a temporary but much-needed boost to the beleaguered American auto industry. The rebate program helped trim inventories by 86,000 units in February, reducing stocks 17% below their year-ago level. Despite a sizable gain in production, inventories were undoubtedly cut further in March as sales soared. But when the rebates end, even this lower level of stocks may leave automakers uneasy if sales plunge again. Industry planners are well aware that the current sales rally may well prove to be at the expense of future sales, and they are planning production schedules accordingly.

There is little in the sales outlook for the balance of the year to suggest much improvement over 1980, which was the worst year for the U.S. auto industry in nearly two decades. Domestic car sales for calendar 1981 are expected to total some 9.2 million units, only about 2% higher than last year. Nearly 190,000 auto workers were still on indefinite layoff in February, and production costs are soaring because of the massive retooling and redesign effort undertaken by the auto companies.

The uncertain element in this year's auto forecast, of course, is imports. In the face of bleak sales projections, protectionists have argued that the auto industry is in dire straits. They have lobbied strongly for measures that would hold Japanese-built cars imported into the United States to 1.2 million units per year through 1985. This would be some 33% lower than the 1.8 million sold here last year when the Japanese captured a record 26.7% of the U.S. market. Instead of requesting any formal measures to restrain Japanese imports, however, President Reagan has opted for a much more informal approach, suggesting to the Japanese that they take it upon themselves to curb auto shipments to this country in the interest of preserving sound trade relations. The administration also plans to announce shortly a package of tax and regulatory changes designed to provide some cost relief to domestic auto producers.

The onslaught of foreign cars, for all the suffering it has caused in the U.S. industry, has served to focus attention on the changed structure of the auto industry around the world that has resulted from the shift in consumer preferences toward smaller, more fuel-efficient vehicles. Auto markets are no longer segmented by regional and national boundaries. The policy approach adopted by President Reagan will provide only minimal soothing of the auto industry's current pain. But the refusal to erect new trade barriers, coupled with a reduction of the crushing regulatory burden on auto manufacturers will do much more over the longer term toward bringing the industry back to health.

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1979		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
												12-month changes							
		latest data	12-month change	in billions of dollars	real growth	latest data	reserves (less gold) in $ million	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	latest data	consumer prices	latest data	money supply(M1)	central bank rate	exchange rate in U.S. dollars	current monetary conditions	
																March 25, 1981			
Austria	Zero growth or a small GDP decline expected for 1981, after 1980 real growth of some 3.5%.	Oct.	+ 3%	67.9	+ 4.6%	Jan.	4,940	+ 31%	2.4	0	Current-account gap 47 billion schillings in 1980; some narrowing seen for 1981.	Jan.	+ 7%	Nov.	+ 9%	6.75%	.0678	Credit moderately restrictive.	**Austria**
Belgium	Leading indicators continue to point down as German recession is felt; incomes policy in place.	Dec.	— 16%	118.9[1]	+ 2.1%[1]	Jan.	7,787	+ 42%	1.4	0	Current-account gap over $6 billion in 1980; further widening likely in 1981.	Feb.	+ 7%	Sept.	+ 1%	12.00%	.02924	Interest rates raised in wake of renewed franc weakening.	**Belgium**
Britain	Output continues to decline as the government introduces third successive deflationary budget.	Jan.	— 12%	403.1	+ 0.9%	Jan.	20,903	+ 2%	2.1	622	Payments balance for first two months of 1981 in surplus by over $4 billion.	Feb.	+ 13%	Dec.	+ 6%	12.00%	2.2635	New money growth target range represents policy easing.	**Britain**
Denmark	Industrial production currently more than 10% below year-ago level.	Nov.	— 4%	65.0	+ 3.5%	Jan.	3,288	+ 19%	2.1	0	January trade gap narrowed to kr. 1.02 billion, vs. kr. 2.23-bn. gap in Jan. 1980.	Dec.	+ 11%	Oct.	+ 5%	11.00%	.1522	Money supply growth rate in 1980 was 10.9%.	**Denmark**
Finland	Economy continues to grow at a healthy pace.	Nov.	+ 3%	40.4	+ 7.2%	Jan.	1,624	+ 7%	1.2	83	Payments deficit reached 5 billion markkaa last year, vs. 0.8 billion in 1979.	Jan.	+ 13%	Sept.	+ 9%	9.25%	.2481	Monetary policy remains tight.	**Finland**
France	Presidential elections unlikely to provide major impetus to business.	Jan.	— 8%	475.2	+ 3.2%	Dec.	27,340	+ 56%	2.5	0	Reduced import demand may narrow 1981 current-account deficit.	Feb.	+ 13%	Nov.	+ 11%	9.50%	.2030	Money tight in short run; franc weakness likely by yearend.	**France**
Germany	Foreign orders surge, but other main indicators continue to fall; real GNP decline expected in 1981.	Jan.	— 5%	766.8	+ 4.5%	Jan.	46,569	— 10%	3.0	0	Decline in mark versus dollar boosting oil bill in mark terms.	Feb.	+ 6%	Jan.	+ 6%	7.50%	.4793	Fall in U.S. rates permits easing of rates from Feb. highs.	**Germany**
Ireland	Slow pace of economic growth expected during 1981.	Sept.	— 10%	14.7	+ 1.9%	Jan.	2,687	+ 21%	3.0	0	Exports holding up despite cost rises and slow growth abroad.	Nov.	+ 18%	Nov.	+ 16%	12.75%	1.7475	Large budget gap forces tight controls on private credit.	**Ireland**
Italy	Economic downturn continues; inflation still exceeding 20%.	Jan.	— 6%	324.2	+ 5.0%	Jan.	22,089	+ 12%	2.6	0	Current-account gap estimated at $10 billion in 1980.	Feb.	+ 20%	Nov.	+ 14%	19.00%	.000962	Credit tightened; small-denomination loan growth limited.	**Italy**
Netherlands	Industrial production sustains decline as recession intensifies.	Dec.	— 2%	148.8	+ 2.3%	Jan.	11,211	— 32%	1.7	0	Trade gap smaller than feared as high gas prices boost export receipts.	Feb.	+ 7%	Nov.	+ 4%	9.00%	.4323	Interest rates ease somewhat—in line with Germany.	**Netherlands**
Norway	Most industries facing problems, but booming oil sector will allow steady output growth in 1981.	Nov.	0	44.5	+ 3.2%	Jan.	5,322	+ 26%	3.8	0	Another large trade surplus in February; healthy balance likely for all of 1981.	Jan.	+ 15%	Nov.	+ 12%	9.00%	.1863	Tight money policy sustained, owing to high inflation.	**Norway**
Portugal	Investment buoyant, but drought will affect 1981 agricultural output.	June	+ 7%	19.7	+ 3.2%	Dec.	795	+ 15%	1.1	108	Exports weak in IV Q 1980; $1 billion current-account gap last year.	Nov.	+ 12%	July	+ 26%	18.00%	.0178	Financial system highly liquid.	**Portugal**
Spain	Domestic and external demand remain depressed.	June '79	— 3%	195.9	+ 1.5%	Nov.	11,969	— 11%	4.3	256	Current-account shortfall of $4.8 billion in 1980; worsening likely in 1981.	Dec.	+ 15%	Nov.	+ 14%	8.00%	.0011795	M3 growth reduced to 16% in December.	**Spain**
Sweden	Economics Ministry now predicts real GDP growth of some 0.4% in 1981.	Nov.	— 2%	100.6	+ 3.7%	Jan.	2,993	— 14%	1.1	0	Current-account gap of 12.3 billion kronor in 1980; little change expected in 1981.	Dec.	+ 14%	Dec. '79	+ 16%	12.00%	.2188	Some monetary easing now possible after January tightening.	**Sweden**
Switzerland	Latest industrial orders reflect continued economic strength; overseas demand likely to weaken.	Dec.	+ 1%	99.0	+ 0.7%	Jan.	12,400	— 7%	4.4	0	Export order books remain healthy.	Feb.	+ 6%	Nov.	+ 6%	4.00%	.5249	Monetary conditions to stay tight for mark/franc stability.	**Switzerland**
Turkey	Domestic recession continues; new credits sought to finance import bill.	n.a.	n.a.	69.3	+ 1.7%	Sept.	1,190	+ 15%	2.2	1,028	Exports and worker remittances rose sharply in November-December.	Sept.	+ 101%	Nov. '79	+ 11%	—	n.a.	Credit continues highly restrictive.	**Turkey**
Canada	Current manufacturing problems attributed to shortages of capital and skilled labor.	Jan.	1%	222.3	+ 2.7%	Jan.	2,523	— 17%	0.5	0	Current-account gap of $1.5 billion in 1980 was lowest since 1974.	Feb.	+ 12%	Jan.	+ 7%	16.59%	.8468	Credit demand strong in face of high interest rates.	**Canada**
United States	Renewed weakness in housing and auto sectors presages GNP decline.	Feb.	— 1%	2,413.9	+ 3.2%	Jan.	17,157	+ 75%[2]	6.8	0	Current-account surplus of $118 million in 1980 likely to be revised up.	Feb.	+ 11%	Feb.	+ 7%	13.00%	—	Market rates drop as short-term credit demands weaken.	**United States**

[1] 1980 1979

World Interest Rates

market rates of Mar. 25, 1981; bond yields as of Mar. 20, 1981

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	13.00 penalty large banks 16.00	16.59	12.00*	12.00	9.50*	7.50*	19.00	9.00*	4.00*	6.25
Day-to-Day Money	14.375 Mar. 26	18.00	13.00*	13.00	11.625*	11.00*	17.50*	9.00*	7.625*	7.875
Treasury Bills 91-day, Middle Rates	12.76	16.35	11.75*	13.75	13.46* one year	n. a.	15.501* 70 day	no dealing	no market	5.875 two month
Commercial Paper prime, 3-month, asked	12.25 finance paper	16.90 finance paper 15% tax w/h	11.36*	11.50 Certified	12.375* Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	13.35	16.70 15% tax w/h	11.75*	11.80 Certified	not traded	9.90*	20.05*	no market	4.50*	no market
Government Bonds Long-term, new and old issues, average yield	12.65	13.97	13.03	11.55 20% tax w/h	14.30*	9.70	16.76*	11.42*	5.43*	8.01
Industrial Bonds prime, long-term, new and old issues, average yield	13.30 Aa Industrials	14.50	14.18	16.27	15.45*	9.65	17.46*	12.15*	6.23*	7.05
Bank Short-Term Rate to Best Borrowers (prime rate)	17.50	17.75	13.00*	15.50	14.35*	12.00*	21.00* ¼ quarterly fee on outstdng.	12.50*	6.00*	7.50
Bank Time Deposits 3-month	13.50 Cert. of Dep	16.00	12.50*	13.50	12.5625*	13.15*	10.75*	10.50* large deposits	8.3125* residents only	5.00 20% tax w/h
Eurocurrencies 3-month, asked	14.75	no market	12.75	no market	12.50	12.5625	no market	10.25	7.9375	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8468	2.2635	.02924	.2030	.4793	.000962	.4323	.5249	.004791
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	2.00 *D*	1.875 *P*	0.50 *D*	2.00 *P*	2.50 *P*	6.50 *D*	4.25 *P*	6.75 *P*	6.125 *P*

Eurodollar Deposits
(London, interbank, bid)
March 26

7-day	14.0625
1-month	14.4375
3-month	14.875
6-month	15.0625

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−0.84*
U.S.-Canada Treasury Bills	−0.73
U.S.-Canada Finance Co. Paper	−2.42
Eurodollars-U.K. Local Auth. Deposits	+0.02*

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	14.25
Over 7 yrs.	14.75
DM Bonds	
7 yrs. and under	10.125
Over 7 yrs.	9.90

Gold Price
London afternoon fixing
528.00
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

* Market rates as of March 18; bond yields as of March 13.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	11.3 (Feb.)	12.2 (Feb.)	12.5 (Feb.)	12.7 (Feb.)	5.5 (Feb.)	19.5 (Feb.)	6.0 (Feb.)	7.4 (Jan.)
Industrial production*	−1.2 (Feb.)	−0.5 (Jan.)	−11.9 (Jan.)	−8.1 (Jan.)	4.8 (Jan.)	6.4 (Jan.)	1.0 (Dec.)	3.5 (Jan.)
Trade balance† *(billions of local currency units)*	−$5.44 (Jan.)	C$0.68 (Jan.)	£0.31 (Feb.)	−FF3.90 (Feb.)	DM0.92 (Jan.)	−Lit.1,500 (Jan.)	−SF0.78 (Feb.)	¥303 (Feb.)
Money supply (M1)*	6.6 (Feb.)	6.7 (Jan.)	5.9 (Dec.)	11.1 (Nov.)	5.8 (Jan.)	13.7 (Nov.)	5.7 (Nov.)	1.8 (Dec.)
Velocity of money (M1)*	4.6 (Dec.)	5.6 (Sept.)	8.7 (June)	n. a.	3.0 (Sept.)	6.6 (Sept.)	n. a.	12.5 (Sept.)
Reserves minus gold *($ million, change from previous month)*	1,560 (Jan.)	−570 (Jan.)	247 (Jan.)	−1,240 (Dec.)	689 (Jan.)	−1,051 (Jan.)	−3,256 (Jan.)	1,285 (Jan.)

* Percent change from 12 months earlier

† Figures are only for the month indicated

U.S. Policy in Transition

The following is based on remarks given by **Willard C. Butcher,** *President and Chief Executive Officer of The Chase Manhattan Bank, N.A., before the American Chamber of Commerce in Paris, France on March 12, 1981. Mr. Butcher formally assumes the chairmanship of Chase at the end of April when David Rockefeller steps down.*

President Ronald Reagan took office in January, but the significance of his presidency has become increasingly apparent since the announcement of his economic program last month. Mr. Reagan has proposed substantial spending and tax cuts. Taxes would be slashed $54 billion in the first year of his program. Over a three-year period, individuals would receive tax cuts that would total an average of 30%. Government spending would decline about $45 billion in year one.

What is more important than the specific numbers, however, is the significant change in direction that the President has taken. We are seeing the first serious program in almost half a century to alter the economic course of the United States. And it has arrived not one moment too soon.

Government growth has been out of control for more than a decade, and President Reagan aims to bring it back under control. But as important as the President's program is—it is but the first step on a long road to economic rehabilitation. I expect the new administration to refortify other fundamentals including defense, energy, and trade policy.

There are those who might express some disappointment that the Reagan economic package's proposed cuts are not large enough. And laid against the context of massive government growth in the United States, there may be some merit to that argument. After all, the government's insatiable appetite for our money is well documented by the rapid rise in taxes as a percentage of national income. Through deficit spending and the inflation it spurs, government has been swallowing a growing share of private savings too.

Clearly, an argument can be made for major surgery on the U.S. budget. The cuts President Reagan has announced thus far may appear small, but the change of policy direction they represent is historic.

The spending cuts also are equitable. More than a few oxen are being gored—including one or two of my own favorite programs. Spending cuts have to be big enough to be credible, but not so big that they could never get through Congress. In this context, I think President Reagan learned something about spending cuts from the previous administration. President Carter proposed cuts that were too small to have a significant impact on government spending. Since the overall package was not meaningful, no legislator was willing to sacrifice his favorite spending program for a package that was largely symbolic. So what began as a very modest spending-cut proposal was whittled down to next to nothing.

On the other side of the ledger are the President's proposed tax cuts, which recognize that productivity gains depend on lower taxes for business and individuals.

As Governor of California, Mr. Reagan enjoyed considerable success steering his programs through a legislature controlled by the opposition party. This experience should serve him well over the next several months. And so will the mandate he has been given by the American people.

Indeed, I believe the Reagan victory and the continued support of his economic package herald a major—and I hope, lasting—shift in American popular opinion. Years of negligible growth and persistent inflation have caused Americans to question the statist principles that were a virtual orthodoxy over the past two decades. I therefore believe that recalcitrant liberal legislators—remembering the fate of their colleagues in the last election—will think twice before obstructing a spending and tax-cut program that has broad public support.

As you might suspect, most American businesspeople are heartened by recent trends in the United States. I know I am. On a broader scale, I sense that what is happening in the United States reflects a growing trend in wider parts of the world as well. The concern for sound economic and political fundamentals is growing. The past elections in Great Britain and Jamaica are examples, and so is the ongoing concern for stable economic growth and productivity displayed in France, West Germany, and Japan.

Governments everywhere in recent decades extended their reach into areas that had been the purview of private citizens. Moreover, as governments have assumed added powers, they have tended to neglect what British historian Paul Johnson has called the "three essential activities" of any government: to maintain *first*, external security, *second*, internal tranquility, and *third*, a sound national currency. In recent times, government has grabbed for extra powers outside its traditional realm, and it has capitulated in those three key areas for which it is primarily responsible.

Fortunately, there seems to be a renewed concern

U.S. Policy in Transition *(continued from page 7)*

for the fundamental well-being of the state. This should have a far-reaching impact that will go well beyond domestic economic policy. By addressing these "fundamentals," I expect to see in America such things as a stronger defense posture, a more forceful energy policy to reduce our dangerous dependence on OPEC oil, and renewed concern for *fair*—as well as *free*—trade.

Without question, there is renewed concern in Washington for defense. Military spending, long neglected, is budgeted to increase. What is more important, foreign policy will be more consistent and purposeful under the new administration. I expect President Reagan to take a pragmatic approach to international affairs. His first concern, as is should be, is what is best for America. But he is mindful of the essential interdependence of our world and the importance to the United States of vigorous allies. Although U.S. concern for individual rights and personal freedom will not diminish, I expect U.S. policy to be more consistent with our overall strategic concerns.

One fundamental strategic concern that the United States shares with France and other industrialized nations, is the need to develop and maintain reliable energy sources. We simply must reduce our dependence on Mideast oil. The OPEC oil surplus this year again is likely to exceed $100 billion. Despite all the talk of recycling, such a huge OPEC surplus represents a transfer of wealth that comes directly out of the pockets of each one of us.

The initial effects of the oil price increases of 1979-80 have been less severe on the world economy than the increases of 1973-74. But over the longer term, these oil price shocks may prove even more debilitating. And the surplus may remain high for a sustained period, raising questions about the ability of weaker economies to finance payments deficits.

Our dependence on Mideast oil—as the war between Iran and Iraq has graphically underscored—makes us increasingly more vulnerable. The free world must therefore act with unity in devoting increased resources to energy self-sufficiency. Although the record of the United States has improved, we remain laggards in the effort to free ourselves from high oil imports. We cannot hope to eliminate totally our dependence on oil imports, but we can reduce this dependence to more manageable proportions.

President Reagan has chosen wisely to deregulate the price of domestically produced oil. This should be an important contributor to production and conservation. However, we must have a multi-faceted attack that also would include greater use of such resources as coal and nuclear power.

Finally, I also expect a new pragmatism in the United States with respect to trade policy. The American automobile, steel, and other industries have been assaulted by foreign competition. We hear frequent calls to batten down the hatches against imports and shield our workers from foreign competition.

To succumb to protectionist pressure, however, would be disastrous to the entire world economy including, ultimately, the United States itself. Yet it is difficult to fight such protectionist sentiment in the United States when there is an apparent unwillingness on the part of some trading partners to open up their markets, or to eliminate the strictures they place against foreign business.

Our global economy remains replete with deterrents to free—and more specifically, *fair*—trade. These deterrents—such practices as import dumping and tariff and nontariff barriers to exports—can be found in every trading nation. I am certain, for example, that it would not be difficult for foreign observers of the U.S. economy to document examples of U.S. policies that stifle imports.

Over the years, we have achieved much progress in opening up the channels of trade through successive rounds of the General Agreement on Tariffs and Trade (GATT) negotiations. But I fear that we have reached a point of diminishing returns when it comes to addressing the elusive yet persistent nontariff barriers that stifle exporters in many nations.

While I do not in any way wish to curtail multilateral conversation, I do think there is mounting interest in supplementing these negotiations with more meaningful and equitable bilateral agreements between nations. I believe fair trade depends on three principles: no dumping of subsidized or surplus goods; sensitivity to the well-being of essential domestic industries; and reciprocity. I believe these three concerns can be addressed most effectively in a bilateral context. If we do not have meaningful and even-handed trade policies, I fear the hue and cry for protectionism in the United States and around the world will mount. The consequence of inequitable trade policies is always less trade. The greatest assurance of free trade is fair trade.

America's renewed commitment to buttressing its economic and political fundamentals obviously entails some practical, hard-headed self-interest. This does not mean that we are turning our backs on our allies or the world in general, however. We cannot escape the fact that the world is moving closer together or, put another way, is becoming increasingly "globalized". Our prosperity depends on world trade and our survival depends on world peace.